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Report on the Export Development Corporation's Environmental Review Framework



May 2001

Office of the Auditor General of Canada
and the Commissioner of the Environment and Sustainable Development





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The audit work reported in this report was conducted in accordance with the legislative mandate, policies, and practices of the Office of the Auditor General. These policies and practices embrace the standards recommended by the Canadian Institute of Chartered Accountants.

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Ce document est également disponible en français.

© Minister of Public Works and Government Services Canada 2001
Cat. No. FA3-34/2001E
ISBN 0-662-30505-1



EcoLogo^M Paper / Papier Éco-Logo^M

AUDITOR GENERAL OF CANADA



VÉRIFICATEUR GÉNÉRAL DU CANADA

The Honourable Speaker of the House of Commons,
The Honourable Minister for International Trade,
The Board of Directors of the Export Development Corporation

I have the honour to transmit herewith my report on the audit under subsection 132(6) of the *Financial Administration Act* of the Environmental Review Framework and other environmental practices established by the Export Development Corporation.

Sheila Fraser

Sheila Fraser, FCA
Interim Auditor General of Canada

OTTAWA, 15 May 2001

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Report on the Export Development Corporation's Environmental Review Framework

Terms of Reference

1. On 27 July 2000 the Governor General in Council, on the recommendation of the Minister for International Trade, asked the Auditor General to do the following:

- audit the suitability of the design of the Environmental Review Framework and other environmental practices of the Export Development Corporation;
- audit the implementation of the Environmental Review Framework and other environmental practices of the Corporation and determine whether the Framework was operating effectively from April 1999 to 31 December 2000; and
- report the audit's results to the Board of Directors, the Minister for International Trade, and the House of Commons.

2. We carried out the audit pursuant to subsection 132(6) of the *Financial Administration Act*. We identified elements that would characterize a suitably designed environmental review process and compared them with the Export Development Corporation's Environmental Review Framework and the documented policies of similar institutions. We also reviewed how the Corporation was applying the Framework in practice. Further details about our scope and approach can be found in *About the Audit* at the end of this report.

PART I

Executive Summary

3. The Export Development Corporation's mandate is to support and develop Canada's export trade. The Corporation was established in 1944, became a Crown corporation in 1969, and had its mandate broadened and its powers expanded in 1993 to better serve the needs of Canadian exporters. The Corporation estimates that it supported \$45 billion in exports and foreign investments in 2000, an amount equivalent to nearly four percent of Canada's gross domestic product.

4. Since its creation, the Corporation has developed a broad range of financial services to support Canadian exports. Consistent with the expectation that it operate in a financially sound manner, the Corporation has developed sophisticated tools, practices, and policies to measure and manage financial risks.

5. From the early 1990s, as part of its risk management process, the Corporation has reviewed projects for their environmental impact. Two years ago, it introduced its Environmental Review Framework to formalize and strengthen its environmental procedures (see Appendix A for the Framework). The Framework was developed at a time when few export credit agencies were seeking to manage environmental risks. These agencies looked to the Corporation for leadership in integrating environmental considerations into project financing decisions.

6. The yardsticks have moved since the Corporation put the Framework in place. Now most international financial institutions, including export credit agencies, have environmental policies and procedures. A consensus is emerging on the elements of good practice that an international financial institution should adopt to ensure that the projects it supports are environmentally and socially responsible. Led by the group of eight

major industrialized democracies (G-8) and the Organisation for Economic Co-operation and Development (OECD), efforts are under way to develop common environmental guidelines for export credit agencies, drawing not only on their experiences but also on good practices of all international financial institutions. The yardsticks will continue to move.

Is the Environmental Review Framework suitably designed?

The Framework has most elements of a suitably designed environmental review process

7. Our analysis of the Corporation's Environmental Review Framework and the environmental policies of other institutions indicates that the Framework contains most elements of a suitably designed environmental review process. It shows the following:

- how the Corporation will identify environmental risks;
- the information it will need to assess them;
- the circumstances under which it will decline to support a project or make its support conditional; and
- the process for monitoring and reporting to ensure that risks are appropriately managed.

In those respects, the Framework compares favourably with the policies of other export credit agencies around the world.

There are important gaps in public consultation and disclosure

8. To remain a leader, the Corporation will have to act quickly to address issues of transparency: a lack of policies and procedures at project level to govern public consultation and disclosure of environmental information. While these gaps are common among the world's export

credit agencies, public consultation and disclosure are essential elements of a credible environmental review process. The approaches taken by other international financial institutions provide useful models for disclosing more information to the public, while maintaining commercial confidentiality for customers.

Is the Framework operating effectively?

There are significant differences between the Framework's design and its operation

9. When the Corporation introduced its Framework, it set the goal of making environmental review part of its everyday due diligence practice. In examining whether the Framework was operating effectively, we did find cases where the Corporation's staff followed it closely. And in those cases, the Corporation had been able to make a well-informed assessment of the project's environmental consequences, how adverse effects should be prevented or mitigated, and whether the Corporation should be involved in the project and on what terms.

10. However, in most cases we found significant differences between the Framework's design and its operation. In those cases employees seem to have viewed the Framework more as guidance, to be interpreted according to the circumstances of each project, than as an important risk management tool they were expected to apply. Potential environmental effects were not identified, the Corporation thus based its decisions on incomplete information. We concluded that the Framework was not operating effectively.

Strengthening the Framework and its operation

11. To strengthen its environmental review process, the Corporation needs to make changes in both the design and the operation of the Framework. Our detailed recommendations are

presented on pages 18, 25 and 26 of this report. In brief, we recommended the following:

- To close the gaps in the Framework's design, the Corporation should focus on enhancing transparency through public consultation and disclosure.
- To strengthen the Framework's implementation, the Corporation should concentrate on improving the tools that identify environmental risks (the screening process) and on monitoring to ensure that the Framework is operating effectively.

12. It will take time for the Corporation to meet the goal of routinely integrating environmental considerations into its risk management practices. It will also take strong leadership from the Corporation's management and its Board of Directors to raise environmental risk management to the high standard they established for financial risk management. Without strong leadership, environmental risks could go undetected, and the Corporation could be criticized for falling short of the due diligence implied in its own Framework.

The Export Development Corporation's responses to our recommendations are included on pages 18 to 20 and page 26 of this report. The Corporation agrees with our assessment and is committed to making environmental review a part of its everyday due diligence practice. It presents the steps it is taking or intends to take to address our recommendations on the Environmental Review Framework's design and operation.

The Minister for International Trade's response to our recommendation is included on page 27 of this report. The Minister notes the generally positive assessment of the Environmental Review Framework's design but expresses concern about the Corporation's performance in implementing it. Consequently, the Minister asks the Auditor General to audit the Framework's design and operation again in two years rather than in the three years recommended in this report.

PART II

Background

The Export Development Corporation

Mandate and powers

13. The Export Development Corporation's mandate is to support and develop Canada's export trade. The Corporation was created in 1944, as the Export Credits Insurance Corporation, to provide credit insurance and guarantees for Canadian exporters. In 1969 it became a Crown corporation and gained additional powers — to make direct loans to foreign borrowers and to borrow on the credit of the Government of Canada to fund its operations.

More than 40 percent of Canada's total production of goods and services is exported to other countries.

14. In 1993 the *Export Development Act* was amended to broaden the Corporation's mandate and to expand its powers to better serve Canadian exporters. The expanded powers allowed the Corporation to offer domestic financing and credit insurance, make equity investments, lease goods to users outside Canada, incorporate subsidiaries, and enter into joint ventures.

Business activities

15. The Corporation generates its operating revenue through fees, premiums, and interest on loans; it does not receive parliamentary appropriations to finance its operations. In 2000 it reported a net income of \$194 million, corresponding to a 9.7 percent return on shareholder's equity. The Corporation estimates that it supported \$45 billion in exports and foreign investments in 2000, an amount equivalent to nearly four percent of Canada's gross domestic product.

16. Two thirds of this business volume was in short-term accounts receivable insurance, which protects an exporter against the risk of non-payment by the purchaser. Other business is in longer-term services:

- direct loans to foreign buyers of Canadian goods and services (17 percent);
- contract insurance and bonding to guarantee bids for goods and services (9 percent); and
- political risk insurance against transfer of funds, expropriation, and political violence (7 percent).

17. In 2000 the Corporation supported sales and investments in 165 countries. Almost three quarters of its business volume was in North America and Europe; just under one quarter was in developing countries. Small- and medium-sized firms (up to \$25 million in annual sales) accounted for 89 percent of the Corporation's customer base and 16 percent of its business volume.

18. **The Canada Account.** A small share of the Corporation's business volume (less than one percent in 2000) falls under the Canada Account. This represents transactions that support export trade but involve risks, amounts, or terms that fall outside the Corporation's usual lending or insurance criteria. They require the authorization of the Minister for International Trade and the concurrence of the Minister of Finance. The Corporation's Board of Directors is responsible for ensuring that the Canada Account transactions are administered appropriately.

Risk management

19. Consistent with its mandate to operate in a financially sound manner, the Corporation has developed sophisticated tools, practices, and policies to measure and manage financial risks. It has a Risk Management Committee of the Board of Directors and recently developed its Credit Risk Policy Manual.

20. Our report on our 1999 special examination of the Corporation stated the following:

The introduction of the Risk Management Committee of the Board of Directors in May 1998 lends itself to effective governance of the risk management process and moves the Corporation closer to best practices in this area. The intended change in focus of Board involvement from a transactional review process to a higher level, enterprise-wide risk management will further improve the oversight and governance at the most senior level of the Corporation.

(Quoted in the Corporation's 1999 Annual Report)

Implications of being a Crown corporation

21. Crown corporations are distinct legal entities wholly owned by the government. They have more management autonomy than most other government entities so that they can operate in a more commercial manner. A board of directors oversees the management of each corporation and holds management responsible for the corporation's performance. The government retains power and influence over Crown corporations in areas like appointment and remuneration of chief executive officers and directors and approval of plans and budgets. Crown corporations are accountable to Parliament through a designated Minister.

22. Unlike federal departments and agencies, the Export Development Corporation is not subject to the *Canadian Environmental Assessment Act* or to the *Access to Information Act*. Unlike private sector financial institutions, it is not subject to regulation by the Office of the Superintendent of Financial Institutions, does not pay income tax, is not required to pay dividends, and can borrow at favourable rates on the credit of the Government of Canada.

23. The Corporation must strike a balance between its commercial orientation and its broader public policy responsibilities. How it strikes that

balance has been a source of debate between those who focus on its primary responsibility to promote trade and those who believe it should observe similar standards of responsiveness and accountability as other government organizations.

Recent review of the Export Development Act

24. The *Export Development Act* provided for a review of its provisions and operation five years after the 1993 amendments and every ten years thereafter. In October 1998 the Minister for International Trade appointed the firm Gowling, Strathy & Henderson (Gowlings) to conduct the first review. While the review covered a broad range of issues about the Corporation's expanded mandate and the impact of the 1993 amendments, public policy issues such as disclosure, environmental review, and human rights also figured prominently.

The government, in its response to the review of the Export Development Act, requested this audit.

Report on the Review of the Export Development Act

25. Gowlings submitted its *Report on the Review of the Export Development Act* to the Minister in June 1999. It included an analysis of the Corporation's success in advancing federal policy objectives of transparency and accountability, environment and sustainable development, and human rights. In those areas, the Gowlings report recommended that the Corporation take the following action:

- **Disclosure.** Regularly release to the public certain specific information on its transactions, such as borrower's name, country, exporter's name, amount and type of transaction.
- **Environmental review.** Assess the potential impacts of significant projects, using generally accepted standards that have a clear and transparent methodology (such as those used by the World Bank), and make public the results no later than when it approves the projects.

- **Human rights.** When assessing projects, seek guidance from the federal government where a country's human rights policies are not clear.

Exporting in the Canadian Interest: Reviewing the Export Development Act

26. In July 1999 the Gowlings report was tabled in Parliament by the Minister for International Trade and referred to the Standing Committee on Foreign Affairs and International Trade. The Committee published *Exporting in the Canadian Interest: Reviewing the Export Development Act* in December 1999. This report contained sections on transparency, public disclosure, and accountability; environmentally sustainable development; and human rights.

- **Transparency, public disclosure, and accountability.** The Committee endorsed the principle of mandatory disclosure as recommended in the Gowlings report. It recommended that, as a first step, the Corporation submit its forthcoming disclosure framework for public consultation and commission an independent review after a trial period of several years. The Committee also recommended that the Corporation explore the feasibility of appointing an ombudsman to resolve issues of accountability and compliance with the disclosure framework.
- **Environmentally sustainable development.** The Committee recommended that the *Export Development Act* be amended to require that the Corporation give due regard to Canada's commitments and obligations under international agreements, including those on environment and human rights. It also recommended that the Act be amended to give statutory weight to the Corporation's Environmental Review Framework and to establish criteria for determining eligibility of projects proposed for the Corporation's support. The Committee recommended that the *Auditor General Act* be amended to provide for regular reporting to Parliament on the Corporation's performance in implementing its Framework.
- **Human rights.** The Committee supported the general recommendations of the Gowlings report — the importance of the Corporation

giving due regard to Canada's human rights commitments and the role of an ombudsman in dealing with public information requests and appeals on human rights.

Government's response to the report of the Standing Committee on Foreign Affairs and International Trade

27. The government's response to the Standing Committee's report was announced in May 2000.

- **Transparency, public disclosure, and accountability.** The government acknowledged that the information the Corporation currently discloses provides few details. It noted, however, that the Corporation was making significant strides toward making more information on its activities available to the public. The government agreed with the proposal that the Corporation consider creating the post of ombudsman to deal with accountability, compliance, and access to information, with findings referred to both the Minister for International Trade and the Board of Directors. The government also agreed that an independent review of the disclosure framework was desirable and said the Minister for International Trade would decide whether the Auditor General should be asked to conduct the review.
- **Environmentally sustainable development.** The government said it expected the Corporation to reflect Canadian values on the environment in its activities overseas. It undertook to give statutory authority to the environmental review process within the next 12 months and to confirm the Auditor General's ongoing oversight of the Corporation's performance. Options it would consider for this purpose would be including the Environmental Review Framework in the *Export Development Act* or establishing it in a special regulation under the *Canadian Environmental Assessment Act*. In making its choice, the government said that it would be guided by the five-year review of the *Canadian Environmental Assessment Act*, then under way, and the continuing multilateral negotiations. It agreed that environmental assessments should be made public at an early stage in the approval of project financing, subject to competitive and commercial

considerations and results of discussions on the Corporation's disclosure framework. The government also agreed that the Corporation's Framework should be subjected to further public consultation, as soon as possible, and to regular public consultation to ensure that as standards evolve they are understood.

- **Human rights.** The government stated that the Department of Foreign Affairs and International Trade and the Corporation would strengthen their communication to ensure a timely and systematic exchange of information and guidance on human rights developments in countries where the Corporation does business.

28. In its response, the government also asked the Office of the Auditor General to audit the adequacy of the Corporation's Framework and the Corporation's performance in applying the Framework when assessing specific projects.

The Environmental Review Framework

Before the Framework

29. Since 1974 the federal government has used environmental assessments to predict the environmental effects of proposals requiring federal involvement or decision. Departments and agencies were required to conduct environmental assessments; they were voluntary for Crown corporations and regulatory agencies.

Since the early 1990s the Corporation has reviewed projects for their potential impact on the environment.

30. In 1990 when the government first proposed the *Canadian Environmental Assessment Act*, it stated that Crown corporations operating outside Canada — such as the Export Development Corporation and the Canadian Commercial Corporation — would not be subject to regulation until there was an international consensus on incorporating environmental factors into export support activities.

31. Since the early 1990s the Corporation has reviewed projects proposed for its support to assess their potential impact on the environment. As part of its overall risk management process, this review initially focussed on those impacts that could affect a project's financial risk profile. Most of the projects it reviewed were in the pulp and paper, forestry, mining, chemical and petrochemical, and hydroelectric power sectors, and most had a capital cost of over \$100 million.

32. The Corporation's engineering department conducted the reviews at a depth commensurate with the Corporation's financial involvement in a project. In these reviews it generally relied on World Bank standards and its own knowledge of the industry.

33. At a minimum, the Corporation required that a project comply with regulations of the host country. In addition, some loan agreements contained environmental covenants stipulating that the buyer meet environmental standards that would be internationally acceptable.

Reasons for developing a framework

34. In its December 1997 Corporate Plan, the Corporation committed to formalizing its environmental review procedures. Among the reasons cited by Corporation staff for developing the Framework were the following:

- To provide the public with a better understanding of the Corporation's environmental practices. Although the Corporation had been assessing environmental risks of projects for some time, it had not kept the public informed on the nature or extent of its analysis.
- To communicate the Corporation's needs to project participants. Given that it relied on environmental information provided by project proponents for its risk assessments, the Corporation needed to tell participants what information it required and how it would be used.
- To regulate itself rather than have the government impose regulation. The Framework was, in part, a response to uncertainty arising

from Federal Court cases on how the *Canadian Environmental Assessment Act* applied to Crown corporations and the ministers who authorized their financial support.

Challenges in developing a framework

35. The Corporation faced a number of challenging questions as it tried to integrate environmental factors into its financing decisions. It needed to strike a balance between its commercial orientation and its broader public policy role.

36. **Protecting international competitiveness.** The Corporation, like other export credit agencies, was established to promote national economic and commercial objectives and generate business for companies at home. How could an environmental policy be designed to operate in a way that would not erode the competitive advantages offered by the Corporation?

37. **Respecting the sovereignty of other countries.** The Corporation supports exports and investments in 165 countries that have different economic, social, and environmental conditions and different institutions. Who should decide what is acceptable in a project that may involve complex trade-offs between benefits to some and costs to others?

38. **Determining and influencing environmental outcomes.** Much of the Corporation's business is insuring exporters who are bidding on competitive tenders by overseas buyers of goods and services. Where it helps finance a project, the Corporation has some ability to influence the project's design, but it may get involved too late to influence the project's environmental impacts. Should the Corporation's ability to influence those impacts be a factor in its environmental review process?

The Framework formalized and strengthened the Corporation's environmental review practices.

39. **Finding models to follow.** When the Corporation was developing its Framework, it had few models for building environmental considerations into an export credit agency's financial decisions. The World Bank Group and the Export–Import Bank of the United States were recognized leaders, and the United Nations Environment Programme had its Statement by Financial Institutions on the Environment and Sustainable Development. However, differing mandates, operating methods, and traditions mean that practices in one institution cannot simply be applied wholesale in another. What could the Corporation learn from the experience of other organizations?

40. **Balancing consistency and flexibility.** Each year the Corporation receives many requests for support that may expose it to financial risk. In identifying and managing financial risk, it tries to balance constraints designed to achieve consistency with responsiveness to individual circumstances. How could it maintain a similar balance in identifying and managing environmental risk?

Developing the Framework

41. In 1998 the Corporation hired an environmental consultant to assist in developing the Framework, drawing on the Corporation's previous experience in environmental review. An early version of the Framework was benchmarked against the environmental screening and review procedures of the following:

- United States — Export–Import Bank and Overseas Private Investment Corporation;
- Japan — Export–Import Bank;
- international agencies — International Finance Corporation, World Bank, Inter–American Development Bank, Asian Development Bank, European Bank for Reconstruction and Development; and
- commercial banks.

42. Consultations were held with representatives of the business and environmental communities. Focus groups were held in Vancouver, Toronto, and Montreal and supplemented by

telephone interviews. There was general agreement that a new framework was a good idea. But there was disagreement on key issues such as impacts on competitiveness, implications for sovereignty, disclosure and accountability, screening criteria and scope, appropriate standards, and monitoring.

43. Key federal departments were briefed on the Framework and presentations made to the Corporation's Board of Directors. The Board approved the Framework in March 1999.

Launching the Framework in April 1999

44. The Corporation launched the Environmental Review Framework in April 1999. The cornerstone of the Corporation's environmental practices, it sets out the requirements and procedures for evaluating the environmental impact of projects seeking the Corporation's support (see Appendix A for the Framework).

45. When the Corporation released the Framework, it stated that the Framework "strengthens [our] existing practices through formal recording of current practices; consistency in application; clear guidance on how to screen projects and prepare reports; poses conditions for declining support and for providing conditional support; regular reviews; and annual reporting. It will become a part of everyday due diligence, and will evolve over time through experience gained from its implementation."

46. Exhibit 1 summarizes the key elements of the Corporation's Framework. In Part III of this report, we look at whether the Framework is suitably designed and whether it is operating effectively.

47. Roles and responsibilities. The Corporation delivers its products and services through sector-based business teams. Financial services managers are the contact for customers and borrowers and are responsible for analyzing requests for support. They screen those requests to identify potential environmental risks that would indicate the need for an environmental review.

48. The Industrial Advisory Service is responsible for identifying and assessing the technical and commercial risks associated with transactions, including environmental risks. The Service includes a team leader, three technical advisors on environmental issues, and six technical advisors specializing in specific industrial sectors. They provide business teams with overall guidance on the Framework, conduct environmental reviews, and monitor the Framework's operation.

49. Staff guidance. Staff guidance on the screening process was developed when the Framework was launched. In the fall of 2000, a guidebook on the environmental review process was released with updated procedures and tools for financial services managers. Information sessions were held for business teams that provide medium- and long-term financial services and are planned for other key teams.

Exhibit 1 Key Elements of the Framework

Application	The Framework applies to a project — defined as physical industrial, commercial, or infrastructure development — such as a mine, a smelter, a power plant, or a pulp and paper mill.
Screening process	The Corporation considers whether <ul style="list-style-type: none"> the project has the potential to cause significant adverse environmental effects and risks the nature and level of the support requested has a material impact on the ability of the project to proceed
Environmental review requirements	If significant adverse environmental effects or risks are identified, the Corporation requires an environmental review report, prepared by qualified sources, assessing those effects and risks.
Elements of an environmental review report	The elements of an environmental review report are scope of review, methodology, regulatory context, baseline conditions, impact assessment, mitigation measures, emergency preparedness and response plan, environmental management systems and training, and environmental monitoring.
Consideration of other sources of information	The Corporation may consider information provided by others such as financial institutions and non-governmental organizations.
Decline for support or conditional support	The Corporation will decline to support a project for which the anticipated positive benefits do not justify the significant adverse environmental effects, despite mitigation measures.
Environmental covenants	A legal vehicle that provides the Corporation with a mechanism to prompt action by the project sponsor if an environmental incident occurs or mitigation measures are delayed.
Monitoring and reporting	Monitoring reports on the environmental effects and risks of the project will be reviewed regularly throughout the Corporation's financial involvement in the project.
Progress reporting	In its annual report, the Corporation will report on the implementation of the Framework in a manner that respects commercial confidentiality.
Accountability	The implementation of the Framework will be audited regularly and the Board of Directors will be responsible for ensuring that management fulfils its responsibilities.
Disclosure and confidentiality	Any information that is not known to the public is considered to be confidential and will not be disclosed without the permission of the relevant parties.

Source: Based on the Environmental Review Framework, Export Development Corporation, April 1999 (see Appendix A).

PART III

Is the Environmental Review Framework Suitably Designed?

The environmental review process

50. An environmental review examines a planned project or activity to ensure that potential impacts on the environment receive careful consideration before a decision is made to proceed. The potential impacts are analyzed with a view to preventing or mitigating them. The breadth, depth, and type of analysis depend on the nature and scale of the project and its potential impact on the environment.

51. International financial institutions. Most international financial institutions (development banks and export credit agencies) have adopted a policy requiring environmental review of the projects they support. However, there are significant differences in specific procedures between institutions. Although most require compliance with a host country's legal requirements and application of international good practices, public disclosure of environmental and social information is less common.

A good environmental review process helps ensure that the projects an organization supports are environmentally sound and sustainable.

52. Institutions with a development mandate tend to have a more systematic and comprehensive environmental review process than organizations with a trade mandate. However, this distinction appears to be fading as international financial institutions reach consensus on what constitute the basic elements of good environmental review.

53. How export credit agencies consider the environmental impact of projects has been

highlighted in a number of recent communiqués from leaders of both the Organisation for Economic Co-operation and Development (OECD) countries and the group of eight major industrialized democracies (G-8). In July 2000 G-8 leaders reaffirmed their commitment to develop common environmental guidelines by the next G-8 Summit in July 2001. The OECD Working Party on Export Credits and Credit Guarantees has a work plan to develop a common approach on the environment, as requested by G-8 leaders. The Corporation has been active in this work.

The Framework has most elements of a suitably designed environmental review process

54. For our audit we identified key elements of an environmental review process suitable for an international financial institution. These elements served as our criteria for auditing the Corporation's Framework (see Exhibit 2).

55. We found that the Corporation's Framework has most of those elements. It indicates how the Corporation will identify environmental risks, the information it will need to assess those risks, the circumstances under which it will decline support or will provide conditional support, and the process for monitoring and reporting on compliance with the conditions it sets. In those aspects of the Framework, the Corporation compares favourably with other export credit agencies around the world.

There are important gaps in public consultation and disclosure

56. The key gaps in the design of the Corporation's Framework are in transparency: a lack of policies and procedures to govern public consultation and disclosure of environmental information. These gaps are common among the world's export credit agencies; nonetheless, public

consultation and disclosure are essential to credible environmental review.

57. The Corporation is developing an information disclosure policy that it plans to implement in 2001 following public consultations. We have not reviewed the policy. However, the approaches taken by other international financial institutions (the World Bank Group's International Finance Corporation and Australia's Export Finance and Insurance Corporation, for example) provide the Corporation with useful models for disclosing more project-level information to the public while maintaining commercial confidentiality for customers.

58. Many institutions categorize their requirements for environmental review, disclosure, and public consultation according to the significance of the potential environmental impacts. The greater the potential impact, the more rigorous the requirements for review, disclosure and public consultation. Appendix B shows the system used by the World Bank Group's International Finance Corporation.

Influence is not an indicator of environmental risk

59. As well as potential environmental risk, the Corporation's screening process considers an influence test — whether the Corporation has the leverage to influence a project in order to reduce risk. The Corporation conducts a detailed environmental review of a project only when it has determined that both risk and influence are factors.

60. The Corporation uses the influence test because, in many cases, it or an exporter may have limited ability to obtain environmental information or may get involved too late to influence potential impacts on the environment. In our view, however, the ability to influence a project's impact should not be a criterion for deciding what level of environmental review is appropriate. That decision should be based solely on potential environmental risk.

Some concepts need to be clarified

61. Framework objective. We found a number of areas in the Framework where the Corporation's intentions are not clear. For example, the Framework's stated objective is to "implement a simple, clear, and efficient process for reviewing on a timely basis the best available environmental information on projects for which [the Corporation's] support is sought." In our view, the statement of objective should better reflect the purpose of environmental review: namely, to help ensure that projects the Corporation supports are environmentally sound and sustainable.

62. Framework coverage. The Framework states that it applies to all projects seeking the Corporation's support. It defines a project as a physical industrial, commercial, or infrastructure development or as a major expansion or modification of an existing operation.

63. However, the Corporation does not subject its short-term insurance business to any form of environmental review even though it represents two thirds of the Corporation's business. Export credit agencies commonly exclude short-term insurance from environmental review, but the Framework does not make this explicit. Furthermore, the Corporation has not analyzed environmental risk to determine whether the exclusion is justified; we believe that it needs to do so.

64. Choice of environmental standards. The Framework states that the Corporation will use internationally recognized standards and industry best practices as benchmarks to determine whether significant adverse environmental effects and risks associated with a project have been mitigated appropriately. Some organizations state that they will apply the higher of the host country's or the World Bank's standards unless the environmental review process justifies the use of other standards. However, the Corporation's Framework is silent on the choice of standards.

65. Decision to support a project. The purpose of environmental review is to help the Corporation make an informed decision to support

Exhibit 2 Elements of an environmental review process for an international financial institution

	Main element	Sub-elements	Category
General features	Documented environmental and social review process appropriate to the organization's mandate	Demonstrates that an environmental and social scan of the mandate has been undertaken (such as an assessment, minutes of management meetings)	Standard ¹
		Lists key objectives of the process	Standard
		Defines key terms used in the process (such as project, environment, environmental risk, and environmental effect)	Emerging ²
		Demonstrates management commitment (such as a public statement on process, a management review process)	Standard
		Demonstrates management accountability (such as a designated management representative responsible for decisions under the process)	Standard
		Demonstrates organizational capacity to implement the process (such as trained staff and resources)	Standard
		Provides for monitoring of process conformance	Standard
		Provides for public reporting on the nature and extent of the application of the process	Standard
		Includes a policy commitment and procedures to promote continual learning and improvement in the organization and to inform clients of changing requirements	Standard
Review of financial services applications	Systematic procedures for financial services applications	Provide objective criteria and/or procedures for	Standard
		• classifying all applications by environmental risk regardless of level of financial involvement	Standard
		• determining significance of environmental risks	Standard
		• exempting applications from review	Standard
		• refusing support	Standard
		• special categories such as modifications, expansions, or maintenance	Standard
		• applications that might affect sensitive ecosystems and protected areas	Standard
Contents of environmental assessment reports	Specification of the expected contents of environmental assessment reports	Require third-party review (at arm's length) of the proponent's environmental assessment, where the financial institution's process has determined the potential for significant environmental risks	Emerging
		Include tools for process implementation (such as guidelines for clients, training packages for internal staff)	Standard
		Describe the surrounding environment	Standard
		Describe the intended use of funds or financial support and any related physical structures	Standard
		Describe host country laws, regulations, standards, and other applicable environmental requirements	Standard
		Assess and describe known and potential environmental risks (for example to air, water, land, protected areas)	Standard
		Identify mitigation measures and monitoring required	Standard
		Identify residual impacts after mitigation	Standard
		Prepare an analysis that justifies accepting residual impacts	Standard
		Describe emergency response procedures where there is a significant potential impact on the environment in the case of an incident	Standard
		Identify and assess public and stakeholder concerns	Standard
		Consider alternatives to the undertaking	Emerging
		Consider cumulative effects	Standard

	Main element	Sub-elements	Category
Environmental and social standards	Documented policy and procedures respecting environmental and social standards	Comply with host country regulations and standards	Standard
		Apply international environmental standards and guidelines (such as World Bank Group's standards, ISO 14000, or a numeric standard like the World Health Organization's air quality guidelines)	Standard
		Apply home country standards in the absence of host country or international standards	Emerging
		Ensure due regard for global environmental agreements and conventions (such as Convention on Climate Change, Kyoto Protocol, Montreal Protocol, Convention on Biodiversity, Convention on Environmental Impact in a Transboundary Context, Aarhus Convention)	Emerging
Co-operation among institutions	Documented policy and procedures for co-operation	Co-ordinate environmental review and monitor efforts when more than one financial institution is involved (such as co-financing)	Standard
		Allow flexibility to use existing environmental assessments	Standard
Disclosure	Documented policy and procedures for active disclosure	Define information to be disclosed, by whom and when	Standard
		Establish a format for public disclosure of environmental assessment findings	Standard
Public consultation	Documented policy and procedures for public consultation	Determine the need for public consultation	Emerging
		Identify relevant stakeholders	Emerging
		Notify stakeholders	Emerging
		Receive and summarize public consultation results	Standard
		Document gaps in consultation (for example where consultation was not possible for cultural or political reasons)	Emerging
		Disclose results of public consultations	Emerging
Environmental covenants	Documented procedures that establish and include environmental covenants in contractual agreements	Document any changes or covenants imposed on the application as a result of internal policies, environmental assessment, and public consultations	Emerging
		Monitor and report on compliance with the covenants by the proponent or a third party	Standard
		State the applicant's obligation to take corrective action if monitoring indicates a problem	Emerging
Supervision and monitoring	Documented procedures to define how transactions are to be supervised and monitored by the institution and to ensure compliance with established covenants	Arrange occasional inspections by the institution or a local agent to verify compliance reports	Standard
		Establish follow-up procedures where non-compliance has been identified	Standard

¹ Standard elements, found in a suitably designed environmental review process, are included in the procedures of the majority of the institutions that we examined.

² Emerging elements, also found in a suitably designed environmental review process, reflect the process of only a minority of the institutions that we examined.

a project or not. According to the Framework, the Corporation will not support a project whose anticipated positive effects do not outweigh the adverse environmental effects it is likely to cause, after taking account of mitigation measures.

66. Guidance to staff indicates that the decision to support a project should be based on confidence in the mitigation measures proposed by its proponent, its net environmental impact, and its anticipated positive effects. The Corporation may make its support conditional on the proponent's acceptance of environmental covenants, with provisions for monitoring and reporting.

Public consultation and disclosure of environmental information are essential elements of a credible environmental review process.

67. However, there is no specific methodology for staff to determine when a project should be rejected on environmental grounds. Other international financial institutions have been more explicit, defining pollution prevention and abatement measures and emission levels that are normally acceptable. The World Bank Group's *Pollution Prevention and Abatement Handbook* is an example consistent with the Corporation's policy of applying internationally recognized standards and best practices.

Recommendations

Closing the gaps in the Framework's design

68. To strengthen its Environmental Review Framework, the Corporation should do the following:

- categorize its requirements for environmental review, disclosure, and public consultation according to the significance of the potential environmental impacts by adopting a system similar to that of other international financial institutions such as the World Bank Group's International Finance Corporation and

Australia's Export Finance and Insurance Corporation;

- drop the influence test as a criterion for deciding what level of environmental review is appropriate for a given project; and
- clarify the Framework's statement of objective, its coverage, the environmental standards the Corporation chooses to apply, and the environmental grounds on which the Corporation will decline to support projects.

Public consultations on the revised Framework

69. In its response to the 1999 report of the Standing Committee on Foreign Affairs and International Trade, the government agreed that the Framework should undergo further public assessment as soon as possible and that public consultations should then be undertaken regularly to ensure that the public understands the Corporation's evolving standards for environmental review.

70. The Corporation should hold consultations on the proposed revisions to the Framework, focussing on areas where it may need to balance its commercial orientation with its broader public policy responsibilities.

Export Development Corporation's response: EDC appreciates that in developing their recommendations in respect of Environmental Review Framework ("Framework") design, the Office of the Auditor General acknowledges the operational challenges facing EDC as an export credit agency which operates on the basis of commercial principles. Specifically, the challenge of balancing the need to protect international competitiveness (paragraph 36), respect sovereignty of other countries (37), recognize EDC's ability to determine and influence environmental outcomes varies by project (38), and balance consistency of application with the flexibility to respond to individual transaction circumstances (40).

Additionally, the Office has identified that the environmental review practices of one financial institution cannot simply be applied wholesale to another but that such practices must be adapted to address the mandate, operating methods, and traditions of the specific financial institution (39).

EDC is committed to the continual improvement and evolution of its Framework. Since the Framework's introduction in April 1999, the Corporation has learned a great deal in terms of the efficacy of processes and the suitability of tools employed to support the objectives of the Framework. In this regard, we welcome and generally agree with the observations and the substance of the recommendations made by the Office. In practical terms, many activities are already under way, while others are in the planning and development stages. For example, a number of key information technology improvements have been designed and tested that are expected to substantially enhance EDC's ability to monitor and track the evaluation of projects pursuant to the Framework.

The Corporation is confident that it possesses the necessary business processes, tools, project management methodologies, and experience to comprehensively build on the Office's recommendations to further strengthen the Framework. These include an Enterprise Risk Management-based approach to risk management together with the attendant tools with which to evaluate proposed improvements, to ensure effective implementation, and to monitor and report outcomes.

Specifically, EDC will implement a comprehensive and detailed work plan designed to address specific recommendations made by the Office in respect of Framework design, the details of which are outlined below.

Categorize requirements for environmental review and drop the influence test (68)

- EDC believes that adoption of a categorization system appropriate to its operating environment will deliver sharper focus and improve the efficiency of our environmental review process.
- Based on operating experience to date, we have observed that the broad scope and subjective nature of the Framework may be creating unnecessary challenges and thereby contributing to the inconsistent documentation of the application of specific Framework processes.
- To address this issue, EDC will implement revised project categorization, screening criteria, and screening methodologies and will replace subjective influence indicators with more objective thresholds and exclusion lists, to be developed based on an analysis of environmental risk, business impact, and process

efficacy. This will better enable EDC to apply the appropriate environmental due diligence to projects according to their likelihood to cause significant adverse environmental effects.

- EDC agrees with the Office that the influence test be dropped, given EDC's generally limited ability to affect the environmental impact of projects that the Corporation considers supporting.
- EDC will introduce a corporate disclosure policy which, in addition to providing more detailed disclosure of aggregate information, will provide enhanced project-level disclosure.

Clarify the Framework's objective (68)

- We agree that the purpose of environmental review is to help EDC make an informed decision to support a project or not (65).
- Specifically, the Framework is used to ensure that EDC is suitably informed with respect to the identification and analysis of environmental risks, in order to avoid supporting projects likely to have significant adverse environmental effects which, after taking into account mitigation measures, constitute an unacceptable environmental risk.
- As such, EDC will clarify the objective of the Framework to better reflect its role as an important risk management tool (10) within EDC's existing Credit Risk Management Framework.

Clarify the Framework's choice of environmental standards (68)

- EDC will provide an illustrative list of what EDC considers to be internationally recognized environmental standards and industry best practices to be applied as benchmarks in determining whether significant adverse environmental effects and risks associated with a project have been appropriately identified and mitigated.

Clarify the environmental grounds on which EDC will decline to support projects (68)

- Similar to its credit assessment and approval processes, EDC will continue to develop and enhance appropriate environmental review guidelines and templates for officers.
- These tools will be designed to assist the Corporation in identifying and weighing environmental risks; taking into account project-specific factors such as the nature of the project, industry, and geography, as well

as the political and cultural environment; and in determining whether to accept or reject these risks.

Submit Framework changes to public consultations (70)

- *We agree that in the course of implementing changes to the Framework arising from recommendations made in this report, EDC should hold consultations focusing in particular on the extent to which the Framework balances EDC's commercial orientation with its public policy responsibilities.*

Is the Environmental Review Framework Operating Effectively?

71. As a minimum test of whether the Framework was operating effectively, we considered whether it was operating as designed. In our view the Framework was operating as designed if the Corporation was doing the following:

- applying the screening process correctly;
- reviewing an environmental review report or similar information from proponents on each project seeking its support;
- ensuring that the report dealt with all relevant project activities, described existing or baseline environmental conditions, and identified potential environmental effects, mitigation measures, and monitoring requirements;
- declining or giving conditional support to projects whose significant adverse impacts could not be justified; and
- ensuring that project proponents submitted any monitoring reports required under environmental covenants.

72. We looked at the Corporation's files on 26 projects and on 13 other transactions (not related to a project) that it approved for support. We also looked at files on 6 projects that were declined by the Corporation on environmental grounds and monitoring reports from 5 projects approved before

the Framework was put in place. We interviewed staff members to verify the results of our file review.

There are significant differences between the Framework's design and its operation

73. Exhibit 3 summarizes our audit results of the Framework's operation. We did find cases where the Corporation's staff had followed the Framework closely. In those cases, the Corporation was able to make a well-informed assessment of the project's environmental consequences, how adverse effects should be prevented or mitigated, and whether the Corporation should be involved in the project and on what terms.

When the Corporation introduced its Framework, it set the goal of making environmental review part of its everyday due diligence practice.

74. But overall, we found significant differences between the Framework's design and its operation. In most cases, staff viewed the Framework more as guidance to be interpreted according to the circumstances of each project than as an important risk management tool they were expected to apply. In those cases, potential environmental risks were not identified and the Corporation based its decisions on incomplete information.

There are gaps at each stage of the environmental review process

75. Our review of the Framework's operation found gaps at each stage of the review process: screening for environmental risk and influence, requesting and reviewing environmental information, approving projects, and monitoring. The weaknesses at each stage have a cumulative effect through the process. Only 2 of 25 projects complied with all key elements of the Framework. If risks are not identified, an environmental review is not performed, contract conditions are not imposed, and no monitoring is done.

Screening tools are not applied adequately to identify potential environmental risk

76. The Corporation has developed a screening process to identify proposed projects and other transactions with the potential to cause significant adverse environmental risks. Exhibit 4 illustrates how the screening process works.

77. When assessing a project's environmental risk, the Corporation considers the risks in the industrial sector involved. Mining, oil and gas, power generation, forestry, and pulp and paper are high-risk sectors. If the project is not in a high-risk sector, there are 13 red flag issues that signal a potential for significant effects. Examples include a

project location in or near a designated protected area, a possible need to relocate local people, and a need for infrastructure development to support the project.

78. The screening process also considers whether the Corporation's support will influence the project's ability to proceed. Criteria for determining the degree of influence include whether the Corporation is providing direct support or political risk insurance; whether the client is supplying key design, construction, operating services, or equipment; and whether the World Bank Group or other international financial institutions are supporting the project.

Exhibit 3 Review of the Framework's operation

Projects reviewed	26
Was the screening process applied correctly?	
Projects with potential environmental risk and influence	25
Projects correctly screened for potential environmental risk	17
Projects correctly screened for potential environmental risk and influence	14
Was an environmental review report or similar information reviewed?	
Some environmental information received	10
Did the report contain the required information?	
Baseline environmental conditions, potential environmental effects, mitigation measures, and monitoring requirements identified	7
Were monitoring reports submitted on a regular basis?	4
Did the project comply with all key elements of the Framework?	2
Transactions (not related to a project) reviewed	13
Was the screening process applied correctly?	
Transactions with potential environmental risk	9
Transactions correctly screened for potential environmental risk	7
Was the transaction reviewed for reputational risk?	5

79. The Corporation's financial services managers conduct the initial screening. The results will lead to one of three possible steps:

- An environmental review by the Industrial Advisory Service may be requested by the financial services manager. This review is applied when a project is in a high-risk sector or has red flag issues and when the support of the Corporation or exporter is a determining influence. It determines whether the screening process accurately identified the presence of potential risk and influence.
- The financial services manager may conduct a **reputational review** if a project does not require a detailed environmental review but warrants a minimal review of environmental risk. A reputational review is conducted when there is environmental risk but neither the Corporation nor the exporter is a determining influence. It is also conducted when a transaction (not related to a project) has known environmental implications or the transaction supports an operation in a high-risk sector or with red flag issues. This review may lead the financial services manager to seek an opinion on environmental risk from the Industrial Advisory Service.

- No further review is required for projects that neither are in a high-risk sector nor have red flag issues.

80. Few of the project files we reviewed indicated how the projects had been screened for environmental risk. This made it hard to determine how screening decisions were made.

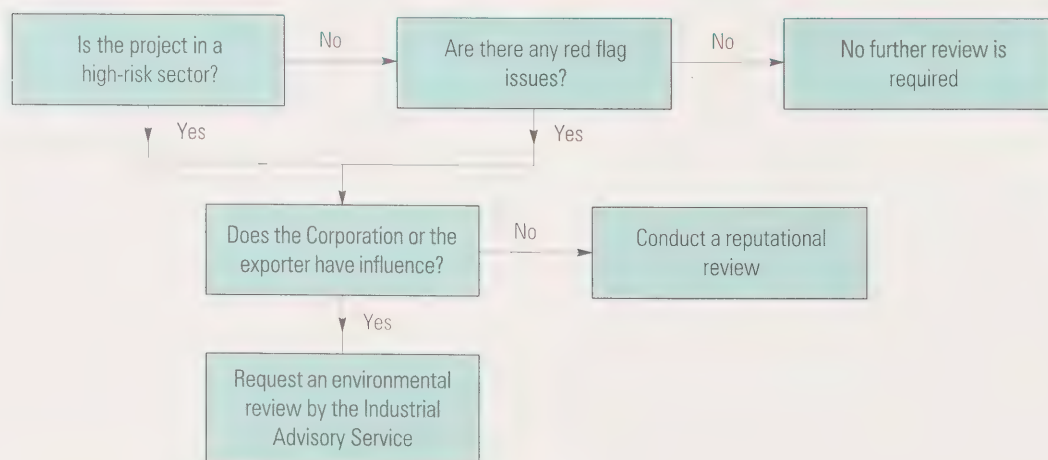
81. Our analysis suggests that all 26 projects we examined were either in high-risk sectors or had red flag issues. Of those, 25 also satisfied the Corporation's influence test. We therefore expected to see an environmental review report or similar information on each of the 25 projects.

82. However, 11 projects were not screened correctly for risk or influence. As a result the Corporation did not ask proponents for more information to assess environmental risk. The environmental review process ended too early.

The Corporation does not request environmental review reports described in the Framework

83. The Framework states that where significant adverse environmental effects or risks are identified, the Corporation will require an environmental review report from the project

Exhibit 4 Environmental screening of a project



Source: Export Development Corporation

proponent. The Framework also identifies the elements to be considered in preparing a report.

84. In 14 of the projects, we determined that the Corporation had correctly screened for risk and influence. However, it received environmental information (generally an engineer's report or an environmental assessment) on only 10 of those projects.

85. The Corporation considered that the projects on which it requested no information were low risk, based on the proponent's representations of compliance with the host country's regulations or on other factors (such as a statement that the project would be built to World Bank standards). But we saw nothing in the files to indicate why the Corporation did not do a more comprehensive review or request additional information.

86. None of the 26 files we examined contained the kind of environmental review report described in the Framework. However, seven project proponents provided much of the relevant environmental information. All seven, for example, identified baseline environmental conditions, risks, and measures for mitigation and monitoring.

87. We also looked at 13 transactions that did not qualify as projects, according to the Corporation's definition, and found a similar pattern. Using the Corporation's screening criteria, we determined that 9 of the 13 transactions presented environmental risk. The Corporation correctly identified risk in seven transactions but did a reputational review of only five.

There is no methodology to determine if adverse environmental risks can be justified

88. One of the Framework's guiding principles is that the Corporation will not support projects if it believes that their anticipated positive effects do not justify the adverse environmental risks they are likely to cause, mitigation measures notwithstanding.

89. We noted earlier that the decision to support a project would be based on confidence in the proposed mitigation measures, the potential

net impact on the environment, and the anticipated positive effects of the project. The Corporation may also provide support conditional on the proponent's acceptance of environmental covenants with provisions for monitoring and reporting.

90. The Corporation decided to support all 25 projects. However, only two of the files contained information on the project's net environmental impact that we could compare with information on its anticipated positive effects. The basis on which the Corporation decided to support the 23 other projects was not apparent.

91. The Corporation did provide us with six requests that it had turned down on environmental grounds. It had enough information on four of the proposed transactions to determine that it could not accept the environmental and reputational risks. In the two other cases, because the companies refused to provide the environmental information requested, the Corporation declined their requests.

Other issues

92. Environmental covenants deal with only some potential environmental risks. The Framework indicates that the Corporation can make its support for a project conditional on the proponent's acceptance of environmental covenants. The Corporation determines those covenants, case by case, taking into account the degree to which it (and other parties involved) can influence the nature and design of the project.

93. In 15 of the 25 projects that we examined, the project agreements contained environmental covenants. All 15 had a covenant to respect the host country's environmental regulations. Few of the agreements had covenants on environmental requirements other than compliance, even though 7 of the projects had identified mitigation and monitoring measures in the information they provided to the Corporation.

94. The Corporation told us that in practice it asks proponents for possible project modifications, mitigation measures, and required reporting in the

project proposal itself rather than requiring them as conditions for its' accepting the proposal. We did not find this practice documented or any information in project files to confirm the statement.

95. Limited evidence of systematic monitoring. Where environmental covenants include a project monitoring requirement, the Framework states that the Corporation will review the monitoring submitted by project proponents throughout the Corporation's financial exposure to the project. The reports are to address whether any environmental effects and risks that emerge are those that were predicted in the proponent's environmental review of the project. The reports are also to provide specific information on any environmental emergencies related to the project.

96. Only four of the project files contained evidence of regular monitoring. Where monitoring reports contained environmental information, it focussed on compliance with the host country's regulations rather than on the broader range of environmental issues specified in the Framework.

97. We also looked at five higher-profile projects that the Corporation had supported before it introduced the Framework to determine how the Corporation was monitoring them. Four projects showed evidence of monitoring.

98. Limited reporting and disclosure. The Framework states that the Corporation will report on its application of the Framework in its annual report and in a manner that respects the confidentiality of information related to its clients and other parties.

99. The Corporation's 1999 Annual Report stated that the Framework had been released. In its 2000 Report the Corporation provided brief examples of its contribution to improved environmental performance of international projects it supported. It said that it had strengthened the training of its financial staff to improve their ability to flag environmental and social concerns in proposed transactions, and it noted that the Auditor General had undertaken an audit of its environmental review practices.

100. The Corporation will not disclose any information on transactions that is not already public, unless it has the permission of the party concerned. However, in four projects we examined we saw indications that the project proponent had released, in the host country, information from the environmental assessment it had provided to the Corporation.

101. The Corporation's disclosure policy. Public consultations on a disclosure policy were completed in September 2000 and the results posted on the Corporation's Web site along with a draft outline of the policy. The disclosure policy is to be implemented in 2001 following further public consultation.

102. Similar weaknesses identified by internal review. The Framework states that its implementation will be audited regularly and that the Corporation's Board of Directors is responsible for ensuring that management fulfils its responsibilities for internal control.

103. Staff sessions were held in May and June 2000 to determine where the environmental review needs to be improved and clarified and what training was needed to make environmental risk assessment effective. Common themes included the following:

- reduce the subjectivity of the procedures by providing more training, guidance, and examples;
- provide staff with more guidance on what constitutes the due diligence that is required;
- increase the Corporation's knowledge of environmental issues; and
- provide more guidance on determining what level of review is appropriate in a given circumstance and how reviews should be documented.

104. Other themes included the following:

- lack of a feedback mechanism to measure whether environmental risks have been adequately identified, whether the Framework is being followed, and whether environmental covenants are being incorporated appropriately in loan agreements;

- a desire for earlier involvement of the Industrial Advisory Service in smaller transactions, before it is too late in the process to complete an assessment of environmental risks;
- lack of clarity about the roles, procedures, and responsibilities for monitoring compliance with environmental covenants; and
- a need for the Industrial Advisory Service to develop guidelines on its environmental procedures.

105. We are not aware of any action the Corporation has taken in response to the concerns raised in staff sessions. So far, no information on the Framework's operation has been reported to the Board of Directors.

Recommendations

A more systematic approach to applying the Framework

106. To strengthen the link between what the Framework says and how it is put into practice, the Corporation needs to focus on two areas: how to identify and categorize environmental risks (the screening process) and monitoring to ensure that the Framework is operating effectively.

We found significant differences between the Framework's design and its operation.

107. Improving the screening of projects for environmental risk. The screening process is the front end of any organizations' environmental review process. Good screening uses information on the nature, scale, and potential environmental impact of a proposed project to determine the breadth, depth, and type of analysis needed. The greater the potential environmental risk, the more detailed the analysis.

108. The Corporation's current screening process is not working effectively. Other organizations (such as the World Bank Group's International Finance Corporation) have developed screening procedures for classifying projects

depending on the type, location, sensitivity, and scale of the project and on the nature and magnitude of its potential environmental impacts (see Appendix B). Adopting such a process would be consistent with the Corporation's policy of applying internationally recognized standards of good practice and with our recommendation to link environmental review, disclosure, and public consultation (see paragraph 68).

109. The Corporation should adopt screening criteria and methodology similar to those used by other international financial institutions such as the World Bank Group's International Finance Corporation and Australia's Export Finance and Insurance Corporation.

110. To put this new methodology into practice, the Corporation should do the following:

- train staff in the new methodology and the exercise of professional judgment in environmental review;
- institute internal peer review of screening decisions to strengthen quality control and enhance staff understanding of good practices; and
- adopt a precautionary approach to screening when uncertainty exists or there is not enough information to make a decision. The Corporation should collect additional information to close any gaps and conduct a full review when the significance of potential environmental effects is unclear.

111. To ensure that its managers and Board of Directors have appropriate, reliable information to monitor the Framework's operation, the Corporation should do the following:

- conduct annual internal audits of the Framework's application, report the results to the Board of Directors, and present a summary in the Annual Report;
- establish a system to reward and communicate best practices and successes; and
- provide staff with guidance on the due diligence required in the application of the Framework.

Export Development Corporation's response: While the audit has found that we did not consistently apply the Environmental Review Framework ("Framework") in the projects reviewed (Exhibit 3), we are confident that overall our support for these projects has been authorized with appropriate environmental due diligence outside of the Framework.

By taking action to improve the design of the Framework and to strengthen internal operating policies and procedures, we are confident that we can build on the recommendations made by the Office of the Auditor General in respect of Framework implementation.

Specifically, EDC will implement a comprehensive and detailed work plan designed to address specific recommendations made by the Office in respect of Framework implementation, the details of which are outlined below.

Adopt screening criteria and methodology similar to those used by organizations like the International Finance Corporation (paragraph 109)

Agree. See management response "Categorize requirements for environmental review and drop the influence test (68)" on page 19.

Training, peer review, and precautionary approach to screening (110)

- As mentioned earlier, EDC will continue to develop and enhance appropriate environmental review guidelines and templates to assist officers in identifying environmental risks.
- We appreciate that the Office has acknowledged the investments EDC has made to train officers responsible for Framework implementation (49). We will continue to place a high priority on investing in appropriate training to ensure effective Framework implementation.
- The benefit of these improvements will be to enable officers to better identify and obtain the requisite environmental information before a decision to approve or decline support to a project is taken.
- In addition to its delegation of authority and independent endorsement processes, EDC will examine whether other forms of peer review and the diffusion

of case studies and best practices would enhance its environmental review process.

Auditing, reporting, sharing of best practices, and guidance (110)

- EDC's authorization policies have been recently amended to clarify accountability for ensuring compliance with the requirements of the Framework.
- EDC will take action to clearly and effectively integrate environmental risk management activities (audit, reporting, oversight, and peer review) within EDC's Credit Risk Management Framework architecture.
- EDC's Internal Audit Group will regularly audit and report to Senior Management and the Audit Committee of the Board EDC's performance, in respect of Framework implementation with a view to ensuring continual improvement. EDC will report on the implementation of the Framework in a section of its Annual Report.
- EDC has made a significant investment in the past two years in information systems and human resources related to transaction origination and asset management. Such investment will allow EDC to better codify project commitments in a more systematic manner, which will facilitate improved monitoring and reporting activities related to the Framework.
- Lastly, EDC welcomes the recommendation that the Office audit design and implementation three years after the revised Framework is put in place (113).

Ongoing review by the Auditor General

112. This audit has established a baseline for assessing the Corporation's environmental review practices. While we are confident that the actions we have recommended will strengthen those practices, ongoing review by an outside party will provide parliamentarians and the public with assurance that improvements are proceeding at an appropriate pace.

113. The Minister for International Trade should consider asking the Auditor General to audit the revised Framework's design and operation three years after it is put in place and to report the results to the Board of Directors, the Minister, and the House of Commons.

*Minister for International Trade's response:*Minister for
International TradeMinistre du
Commerce international

Ottawa, Canada K1A 0G2

The Honourable L'honorable
Pierre S. Pettigrew

Ms. Sheila Fraser
Interim Auditor General
Office of the Auditor General
240 Sparks Street
Ottawa, Ontario
K1A 0G6

Dear Ms. Fraser:

I am writing with respect to the recently completed audit of the Export Development Corporation's Environmental Review Framework. I would like to thank you for undertaking this important task, and furthermore for bringing it to a successful and productive conclusion.

The audit notes that the Export Development Corporation (EDC) has shown international leadership in recognizing the importance of environmental review of projects supported by export credit agencies, and in being among the first to design an environmental review framework. The audit conveys a generally positive assessment of the Framework's design.

However, I am concerned with your findings regarding EDC's performance in implementing its review framework. I am therefore pleased to note that EDC intends to adopt each of your recommendations.

I note your recommendation that the Minister for International Trade should consider requesting an audit of the Framework's design and operation once again in three years, following its revision, and the reporting of the findings to the Corporation's Board of Directors, to the Minister for International Trade and to Parliament. I agree with the principle of this recommendation, although given the adjustments and improvements that are called for, I would ask the Auditor General to commence this audit in two as opposed to three years. This will allow for a more timely assessment of EDC's improvements in implementing the environmental review framework.

Sincerely,

Pierre S. Pettigrew

Canada

Conclusion

114. On the recommendation of the Minister for International Trade, the Governor General in Council asked the Auditor General to determine whether the Export Development Corporation's Environmental Review Framework was suitably designed and whether it was operating effectively.

115. The Framework contains most elements of a suitably designed environmental review process. The key gaps are in transparency: a lack of policies and procedures at the project level to govern public consultation and disclosure of environmental information. While these gaps are common among the world's export credit agencies, public consultation and disclosure are essential elements of a credible environmental review process.

116. In most cases, we found significant differences between the Framework's design and its operation. In those cases, potential environmental risks were not identified and the Corporation based its decisions on incomplete information. We concluded that the Framework was not operating effectively.

117. By launching its Framework, the Corporation took an important first step in strengthening its management of environmental risks. It will have to move quickly to close the gaps in its Framework. This means it must focus on enhancing transparency. The Corporation also will have to be more systematic in managing the application of the Framework to close the gap between the Framework's design and its operation.

About the Audit

Scope and approach

We conducted our audit in two phases.

Is the Environmental Review Framework suitably designed?

First, we looked at whether the Export Development Corporation's Environmental Review Framework and other environmental practices were suitably designed. We developed criteria for a suitably designed environmental review process using the following steps:

1. We examined the findings from a draft confidential study on the environmental and social requirements of international financial institutions. Forty-two institutions, including the Export Development Corporation, participated in this study, under the guidance of the World Bank Group's International Finance Corporation. The study defined minimum requirements of good practice that international financial institutions should adopt to ensure the projects that they support are environmentally and socially responsible. These correspond to the main elements of our audit criteria (see Exhibit 2).
2. We developed sub-elements based on our Office's 1998 audit of environmental assessment (1998 Report of the Commissioner of the Environment and Sustainable Development, Chapter 6). The criteria we used in our 1998 audit defined good environmental assessment practice.
3. We categorized our sub-elements into standard or emerging elements. Standard elements are being used by a majority of institutions; emerging elements are being used only by a minority of institutions. To validate our categorization, we examined the environmental review frameworks of 12 organizations including the export credit agencies of Canada's main trade competitors. We focussed on documented frameworks but did not examine how these frameworks were put into practice.

Is the Framework operating effectively?

To determine whether the Corporation's Framework and environmental practices were suitably designed, we applied the standard criteria. We applied the emerging criteria to indicate the steps the Corporation could take to strengthen its Framework.

Second, we looked at whether the Corporation's Framework and environmental practices were operating effectively. As a minimum test of effective operation, we identified key elements in the Framework and tested whether they were implemented as designed. For each element, we applied the Framework and the Corporation's screening tools to the following:

- A random sample of 26 files for projects approved by the Corporation between April 1999 and December 2000.
- A judgmental sample of 13 files for transactions (not related to a project) approved by the Corporation over the same period. We focussed on higher-risk industrial sectors.
- A sample of 5 files for projects approved by the Corporation before the Framework was put in place in April 1999. This sample reflects projects that have drawn criticism on environmental grounds. We wanted to determine how the Corporation was monitoring them.
- We also reviewed a sample of 6 files for projects that were declined by the Corporation for environmental reasons.

We interviewed the Corporation's financial services managers involved in the transactions, members of its Industrial Advisory Service, and its internal audit and evaluation group.

Audit team

Assistant Auditor General: John Wiersema

Stuart Barr
Andrew Ferguson
Patti-Lou Fowlow
Anne Marie Smith
Richard Smith

For more information, please contact Richard Smith.

Appendix A

Export Development Corporation's Environmental Review Framework

Preface

Export Development Corporation (EDC) is a federal Crown corporation that operates as a commercial financial institution. Its mandate is to support and develop, directly or indirectly, Canada's export trade and Canadian capacity to engage in that trade and to respond to international business opportunities. It is this public policy mandate that distinguishes EDC from other commercial financial institutions.

EDC's flexible financial solutions and services, combined with strategic partnerships and global market reach, help Canadian businesses grow and prosper through international trade and investment.

The objective of the Environmental Review Framework (the "Framework") is to implement a simple, clear, and efficient process for reviewing on a timely basis the best available environmental information on projects for which EDC support is sought. The Framework will be subject to review on a regular basis and will evolve over time as experience is gained from its implementation.

Recognizing the importance of fostering trade competitiveness consistent with environmental conservation, while also remaining sensitive to concerns of extraterritoriality, EDC sought a diverse range of views and expertise in the development of this Framework.

This Framework is based on two guiding principles:

- Environmental reviews undertaken by financial institutions to mitigate project risk can help encourage sustainable development by promoting consideration of the environmental benefits and costs of Projects in host-country jurisdictions.
- EDC should decline support for Projects which, after taking into account the implementation of mitigation measures, are, in its opinion, likely to cause significant adverse Environmental Effects that cannot be justified by the anticipated positive effects of such Projects.

This Framework also reflects ongoing multilateral discussions at the Organisation for Economic Cooperation and Development aimed at strengthening environmental considerations in risk assessment practices of export credit agencies. EDC intends to share its experience in implementing this Framework with its international counterparts and will continue to pursue a multilateral approach to this issue that maintains a level playing field for all exporters.

Definitions

Under this Framework the following definitions are meant to be read in the context of a Project for which EDC's support is sought:

- a) "Environment" means land, water, air, living organisms and interacting natural systems;
- b) "Environmental Effect" means any change that the Project may cause in the Environment, including any social impact or any change to the Project that may be caused by the Environment;
- c) "Environmental Risk" means the potential for an adverse Environmental Effect to occur as a result of the normal construction operation and decommissioning of the Project, or in the event of an accident or malfunction in relation to the Project;
- d) "Environmental Review Report" means a report submitted by, or on behalf of, a party seeking EDC support in relation to the Project and prepared by qualified sources, assessing the Environmental Effects and Environmental Risks, if any, associated with the Project; and
- e) "Project" means a physical industrial, commercial or infrastructure development.

1.0 Screening Process

1.1 This Framework applies to all Projects for which EDC support is sought.

1.2 EDC will seek to identify the significant adverse Environmental Effects and Environmental Risks, if any, associated with Projects where:

- a) there may be the potential to cause significant adverse Environmental Effects as a result of any of the following¹:
 - generation of significant air emissions, liquid effluents, wastes or noise;
 - significant resource requirements (energy, materials, water, land);
 - significant adverse social impacts;
 - location in or near a sensitive geographic area; and where
- b) the nature and level of support requested of EDC has a material impact on the ability of the Project to proceed.

1.3 For Projects where the nature and level of support requested of EDC do not have a material impact on the ability of the Project to proceed, EDC may nevertheless request information from the applicant regarding the environmental aspects of the Project. To acquire comfort with the environmental aspects of these Projects, EDC may consider the corporate environmental policies, environmental management systems and reputation of the applicants and Project sponsors, where applicable.

1.4 For the purposes of Sections 1.2 and 1.3, EDC will draw upon its past experience with similar Projects, and, if applicable, on information contained in a completed screening questionnaire, (Annex 1), and other readily available sources of information on the Project, to identify the Environmental Effects and Environmental Risks, where applicable, associated with a Project.

1.5 Where significant adverse Environmental Effects or Environmental Risks are identified, EDC will require an Environmental Review Report as outlined in Sections 2.0 and 3.0 below.

1.6 For nuclear power Projects, EDC will require submission of the standard environmental reviews and approvals of recognized nuclear regulatory bodies. EDC may nevertheless request an Environmental Review Report as outlined in Sections 2.0 and 3.0 below.

1.7 EDC will not support Projects which, after taking into account the implementation of mitigation measures, are, in its opinion, likely to cause significant adverse Environmental Effects that cannot be justified by the anticipated positive effects of such Projects.

2.0 Environmental Review Requirements

2.1 Environmental Review Reports assessing the Environmental Effects and Environmental Risks, if any, associated with the Project in respect of which EDC support has been requested will be provided to EDC by the party requesting EDC support.

2.2 The submission of existing acceptable documentation is encouraged to improve the efficiency of the review process and to minimize duplication of effort. The environmental review for the purposes of the Environmental Review Report must be undertaken by qualified sources with respect to the nature of the project.

¹The following is an illustrative list of projects where, in EDC's opinion there is potential for significant adverse environmental effects: mining, metals processing; oil & gas development; thermal power generation & transmission; forestry, pulp & paper operations; chemical & petrochemical facilities; hydropower & water resources management; waste and wastewater management; or projects located in or near geographic areas designated for environmental protection such as national parks, tropical rainforests, coral reefs, World Heritage Sites, or World Biosphere Reserves.

2.3 At a minimum, the scope of an Environmental Review Report should focus on activities within the control of the party seeking EDC support.

2.4 Consideration should also be given to the cumulative Environmental Effects and Environmental Risks, if any, that are likely to result from other Projects or activities that have been or will be carried out, to a degree that is feasible and reasonable under the circumstances.

2.5 EDC may nevertheless request additional information in addition to what is contained in the Environmental Review Report.

2.6 EDC will consider internationally recognized environmental standards and industry best practices as benchmarks in determining whether significant adverse Environmental Effects and Environmental Risks, if any, associated with a Project have been appropriately mitigated.

3.0 Elements of an Environmental Review Report

3.1 EDC recognizes that the breadth and depth of analysis undertaken to prepare an Environmental Review Report will depend on such factors as the magnitude, range and complexity of the potential Environmental Effects and Environmental Risks associated with a Project.

3.2 An Environmental Review Report will demonstrate that a Project has been proposed in compliance with host-country environmental regulations and requirements such as provisions for public consultation, licenses, permits and other approvals.

3.3 An Environmental Review Report will also cover measures that are technically and economically feasible to mitigate significant adverse Environmental Effects and Environmental Risks resulting from a Project.

3.4 Notwithstanding that the content and format of an Environmental Review Report will vary depending on the nature of the Project, the site and other project-specific aspects, the following elements should be considered in preparing an Environmental Review Report, to a degree that is feasible and reasonable under the circumstances:

Scope of Review

Description of the current or proposed Project and its potential area of impact including impact receivers.

Methodology

Description of the objectives and procedures of studies contained in the report.

Regulatory Context

Description of requirements pursuant to host-country environmental regulations and requirements such as provisions for public consultation, licenses, permits, and other approvals.

Baseline Conditions

Description of existing environmental conditions.

Impact Assessment

Evaluation of current and potential Environmental Effects and Environmental Risks, if any, associated with a Project including an analysis of the socio-economic benefits and costs, the impact of potential malfunctions or accidents that may occur in respect of the Project and the likelihood of the same occurring, the cumulative Environmental Effects and Environmental Risks that are likely to result from the Project in combination with other Projects or activities that have been or will be carried out, and the impact of the Project on renewable resources.

Mitigation Measures

Description of mitigation measures that are technically and economically feasible to deal with current or potential Environmental Effects and Environmental Risks associated with a Project, as well as alternative means of carrying out the Project to reduce these effects and risks.

Emergency Preparedness and Response Plan

Description of measures to be undertaken in the event of an environmental emergency in relation to the Project.

Environmental Management Systems and Training

Description of environmental management systems (EMS) including the use of internal and external audits. Identification of the need and provisions for employee training to support the implementation of the EMS.

Environmental Monitoring

Description of measures to be undertaken to monitor and report Environmental Effects and Environmental Risks associated with a Project.

Appendices

Sources, credentials and other information.

4.0 Consideration of Other Sources of Information

4.1 As part of its risk assessment and decision-making process, EDC may consider environmental information on Projects which is provided by sources other than the party seeking EDC support, including, without limitation, other lenders or insurers to the Project and/or non-governmental organizations.

4.2 Where appropriate, EDC may request outside expertise to supplement its internal technical capacity to assess the Environmental Effects and/or Environmental Risks associated with a Project.

5.0 Decline for Support or Conditional Support

5.1 EDC will decline support for Projects which, after taking into account the implementation of mitigation measures, are, in its opinion, likely to cause significant adverse Environmental Effects that cannot be justified by anticipated positive effects of such Projects.

5.2 Where details essential to EDC's decision have not been provided to EDC at the time a commitment is required, EDC may decline, or make conditional, its support for the Project.

6.0 Environmental Covenants

6.1 EDC can make its support for a Project conditional on the acceptance of environmental covenants to be determined by EDC on a case-by-case basis, taking into consideration the degree of influence EDC and other parties involved have on the Project and the nature of the Project.

6.2 Environmental covenants, if any, will be developed in consultation with contractual parties. Such covenants will, at a minimum, be consistent with the laws of the host jurisdiction, objective and verifiable, and will provide parties with an opportunity to remedy any breach thereof prior to suspending any support.

7.0 Monitoring and Reporting

7.1 Where environmental covenants regarding project monitoring have been negotiated for the contract, monitoring reports will be reviewed on a regular basis throughout EDC's financial exposure to the Project. Additional reports may be required in the event of an environmental emergency. In any circumstances, EDC may request and review such reports on any Projects where EDC has a financial exposure.

7.2 Monitoring reports should address whether the Environmental Effects and Environmental Risks, if any, associated with a Project are as predicted in the Environmental Review Report and provide specific information in the event of an environmental emergency related to the Project.

7.3 If monitoring were to indicate the occurrence of an environmental emergency related to the Project, EDC will leverage the influence it may have over the Project to bring the appropriate parties together to address the problem or accident and to mitigate any significant adverse Environmental Effects.

8.0 Progress Reporting

8.1 EDC, in its annual report, will report on the implementation of the Framework in a manner that respects the confidentiality of information related to its clients and other parties.

9.0 Accountability

9.1 The implementation of the Framework will be audited on a regular basis. In this regard, it should be noted that EDC's Board of Directors is responsible for ensuring that management fulfils its responsibilities for financial reporting and internal control, and exercises this responsibility through the Audit Committee of the Board, which is comprised of Directors who are not employees of the Corporation. The Audit Committee meets with EDC's management, EDC's internal auditors and EDC's external auditor, the Auditor General of Canada, on a regular basis.

10.0 Disclosure and Confidentiality

10.1 Consistent with commercial practice, EDC considers any transaction information that is not known to the public as confidential and will not disclose such information without the permission of the relevant party or parties, as the case may be.

11.0 Effective Date

11.1 The Framework is effective as at April 12, 1999, and will be subject to review no later than April 12, 2002.

11.2 Comments on the Framework should be addressed to:

Export Development Corporation
c/o Environmental Review Framework
151 O'Connor Street
Ottawa, Ontario K1A 1K3
or e-mailed to: edc@edc-see.ca

11.3 Copies of the Framework are available upon request.

Annex 1

Environmental Screening Document

Transaction Identification :

This document is Annex 1 to EDC's Environmental Review Framework. This questionnaire is designed to assist EDC in its screening process under the Framework. Copies of the Framework are available upon request.

The Project requesting EDC support, in EDC's opinion, may potentially result in significant adverse Environmental Effect(s). Project, as defined in the Framework, refers to a physical, industrial, commercial or infrastructure development.

1. Provide a brief description of the Project and its potential to:
 - a) generate significant air emissions, liquid effluents, wastes or noise;
 - b) demand significant resource requirements (energy, materials, water, land); and
 - c) result in significant adverse social impacts.
2. Describe your role and level of influence in the Project with respect to design, construction and operating responsibilities, where applicable.
3. Does the Project involve the relocation of a local community? Explain.

4. Will the Project be located in or near a geographic area designated for environmental protection including, without limitations, national parks, tropical rainforests, coral reefs, World Heritage Sites or World Biosphere Reserves?
5. Provide a brief description of the Project site and surrounding geographic area. Specify any geographic characteristics of the site (e.g. topography, seismicity, hydrology, etc.) that may affect the mitigation measures of the Project.

Appendix B

Categorization at the International Finance Corporation: linking environmental review, disclosure, and public consultation requirements to the significance of the potential environmental impacts

Category A projects

A proposed project is classified as Category A if it is likely to have significant adverse environmental impacts that are sensitive, diverse, or unprecedented. A potential impact is considered sensitive if it may be irreversible (for example leading to loss of a major natural habitat), affect vulnerable groups of ethnic minorities, involve involuntary displacement and resettlement, or affect significant cultural heritage sites. These projects may affect an area broader than the sites or facilities subject to physical works.

Environmental assessment. A full environmental assessment (EA) is required. Project review by the International Finance Corporation (IFC) involves a visit to the project site to discuss environmental and social concerns and information needs, to explain public consultation and disclosure requirements, and to determine the issues that must be addressed in the EA. The IFC reviews the EA report provided by the project sponsor and other relevant information provided by the project team.

Public consultation. All project sponsors are directed to consult IFC's *Doing Better Business Through Effective Public Consultation and Disclosure: A Good Practice Manual*.

The project sponsor consults at least twice:

- shortly after environmental screening and before the terms of reference for the EA are finalized; and
- once a draft EA report is prepared.

The project sponsor makes the draft EA report available at a public place accessible to project-affected groups and local non-governmental organizations no later than 60 days prior to Board consideration.

For consultation after the draft EA report is prepared, the project sponsor provides a summary of the EA's conclusions. Following the public consultation on the draft EA, the project sponsor supplements the EA by including the project sponsor's responses to concerns raised by the various stakeholders and details of measures taken to incorporate these concerns into project design and implementation. The IFC requires the project sponsor to report on ongoing consultation throughout project construction and operation as part of its annual reporting requirements.

Disclosure. The IFC distributes the summary EA report to members of the IFC's Board of Directors. As required under its policy on disclosure, the IFC also makes the environmental information available through the World Bank InfoShop. If the project sponsor objects to the IFC releasing this environmental information, IFC staff do not continue work on the project.

Category B projects

A proposed project is classified as Category B if its potential adverse environmental impacts are less adverse than those of Category A projects. These impacts are site-specific; few, if any of them, are irreversible. In most cases mitigatory measures can be designed more readily than for Category A projects.

Environmental assessment. The scope of EA is narrower than that of an EA for Category A projects. Project review for a Category B project involves desk review by the IFC of environmental and social information provided by the project sponsor and the project team. A site visit may be required by a member of the Environment Division or by an IFC consultant, depending on the complexity of the project.

Public Consultation. Category A requirements apply as appropriate. On completing its review of the project sponsor's environmental analysis, the IFC prepares a summary that contains the following:

- the project description;
- the rationale for the project categorization;
- the list of key environmental, social, health, and safety issues;
- details of the mitigation measures to bring the project into compliance with IFC's requirements; and
- an outline of any outstanding issues and information on the project's monitoring and reporting program to ensure compliance.

Public Disclosure. The sponsor is also required to release locally the summary and the results of any consultations required by the IFC, translated into the local language and presented in a culturally appropriate manner. This local release should occur no later than 30 days prior to Board consideration. As required under its policy on disclosure, the IFC makes the environmental information available no later than 30 days prior to Board consideration.

Category C projects

A proposed project is classified as Category C if it is likely to have minimal or no adverse environmental impacts. Beyond screening, no further EA action is required and no further environmental review is required.

Source: World Bank Group's International Finance Corporation



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